ARLYNE LANSDALE

IBLA 74-159 Decided June 20, 1974

Appeal from a letter decision of the Utah State Office, Bureau of Land Management, dismissing protest against termination of oil and gas leases U 0146920.

Affirmed.

Oil and Gas Leases: Production--Oil and Gas Leases: Termination--Oil and Gas Leases: Well Capable of Production

Where a lessee seeks to have an oil and gas lease extended on the ground that the lease contains a well capable of producing oil and gas in paying quantities, the well must be one which is actually in physical condition to produce at the particular time in question. Where a well has been drilled, the casing set and cemented, but the casing has not been perforated, the well has never been in a physical condition to produce and the lease terminated at the end of its term.

APPEARANCES: W. J. O'Connor, Jr., Esq., Ray, Quinney & Nebeker, Salt Lake City, Utah, for the appellant; David C. Branand, Esq., Office of the Solicitor, Department of the Interior, for the United States.

OPINION BY ADMINISTRATIVE JUDGE RITVO

Arlyne Lansdale has appealed from a letter decision of the Utah State Office, Bureau of Land Management, dated February 23, 1973, dismissing her protest against the termination of oil and gas lease

U 0146920 at the end of its primary term. 1/ The letter decision presented the facts as follows: 2/

> Leases Utah 0146920 and 0146921 covering lands in Helium Reserve No. 2 were issued competitively to Mrs. Arlyne Lansdale, effective September 1, 1965. The leases were for a primary term of five years and so long thereafter as oil and gas were produced in paying quantities. (30 U.S.C. Sec. 226) During the primary term a well (Lansdale No. 13) was drilled on Utah 0146920 which encountered and produced nonflammable gas at a rate of 10,900 mcf per day 3/ at a depth of 860 feet to 945 feet in the Entrada formation. A 4 1/2-inch casing was inserted through the formation which was not perforated and all drilling operations ceased on or about May 30, 1968. Mrs. Lansdale was not the first to discover gas in the Entrada formation. On May 26, 1931, production of a nonflammable gas from the Entrada formation at the rate of 5000 mcf per day had been obtained by another discovery well at a depth from 860 feet to 945 feet. That well was plugged and abandoned in 1944. The Lansdale No. 13 is located about 292 feet from that well. The record forwarded to this office indicates that there was no other drilling activity on the two Lansdale leases. One final factor is that on July 18, 1968, Mrs. Lansdale entered into a helium extraction contract with the United States which included these leases and required that construction of a helium extraction plant be commenced within three years and completed within four years. On July 15, 1971, the contract was amended to require commencement of construction by August 12, 1976, with completion by August 1977.

Under these circumstances, the State Office decision held that appellant's leases terminated August 31, 1970, at the end of their primary term.

1/ The letter decision also discussed her protest against lease U 0146921. There was no drilling activity on U 0146921 which could have resulted in extending the lease beyond its primary term. Accordingly, appellant did not appeal from that part of the State Office decision terminating this lease.

2/ The letter decision quotes from a memorandum received from the Office of the Solicitor, Department of the Interior, dated January 15, 1973.

3/ Appellant's Well Completion Log (Ex. D), indicates that the correct production figure is 10,400 mcf per day.

On appeal, Ms. Lansdale asserts that the leased land has on it a well capable of producing helium gas in paying quantities, and that under such circumstances 30 U.S.C. § 226(f) provides that a competitive oil and gas lease shall not terminate automatically at the end of its primary term. Section 226(f) states:

> [1] No lease issued under this section which is subject to termination because of cessation of production shall be terminated for this cause so long as reworking or drilling operations which were commenced on the land prior to or within sixty days after cessation of production are conducted thereon with reasonable diligence, or so long as oil and gas is produced in paying quantities as a result of such operations. [2] No lease issued under this section shall expire because operations or production is suspended under any order, or with the consent, of the Secretary. [3] No lease issued under this section covering lands on which there is a well capable of producing oil or gas in paying quantities shall expire because the lessee fails to produce the same unless the lessee is allowed a reasonable time, which shall be not less than sixty days after notice by registered or certified mail, within which to place such well in producing status or unless, after such status is established, production is discontinued on the leased premises without permission granted by the Secretary under the provisions of this chapter. (Emphasis added.)

Any one of the three events cited above could serve to extend the lease beyond the expiration of its primary term. Appellant argues that the requirements of the third provision, i.e., that there exist "a well capable of producing oil or gas in paying quantities," has been satisfied and therefore she is entitled to notice and a reasonable time within which to place such well in producing status. 4/

There are two other issues which could be dispositive of the appeal even assuming there was a well capable of producing gas. One is whether helium gas production could serve to extend the lease. The other is whether well #13 was capable of producing oil and gas in paying quantities. In view of our conclusion, we find it unnecessary to consider these issues.

4/ Appellant's Statement of Reasons in Support of Appeal at 9 reads as follows: "Appellant does not contend that Well No. 13 was in production or that drilling was being carried on at the end of the primary term of Lease No. U 0146920; but that the well at that time was one capable of producing oil or gas in paying quantities."

The State Office, in its letter decision, found the following:

> There was no actual production or drilling operations being diligently prosecuted at the end of the primary term. Also the only well drilled on the leases, Lansdale No. 13, was never completed. The casing was not perforated and therefore the well never became capable of producing oil or gas in paying quantities. United Manufacturing Company et al., 65 I.D. 106 (1958). As a result the lessee was not entitled to a reasonable time within which to place the well in a producing status. * * *

Appellant maintains that the State Office decision has read into the law a factor that is not necessarily required in all cases, namely, that perforation is a criterion for establishing that a well is capable of producing oil or gas in paying quantities. Appellant points out that there are no federal statutes or regulations which call for perforation as a prerequisite to proving productivity. She additionally asserts that United Manufacturing Co., 65 I.D. 106 (1968), and the cases cited therein, are distinguishable on their facts from the situation at hand, and do not go so far as requiring perforation in every instance in order to prove that a well exists which is capable of producing oil or gas.

In United Manufacturing Co., the lessees were appealing from a decision holding that three noncompetitive oil and gas leases terminated automatically for failure of the lessees to make timely payment of the rental. Appellants maintained that the automatic termination provision did not apply to one of the leases because the lease had on it a well capable of producing oil or gas in paying quantities. 30 U.S.C. § 188(b) provides in pertinent part that, "* * * upon failure of a lessee to pay rental on or before the anniversary date of the lease, for any lease on which there is no well capable of producing oil or gas in paying quantities, the lease shall automatically terminate by operation of law * * *." (Emphasis added.) Based on the following facts, the Department found that a well capable of producing oil or gas in paying quantities did not exist on the leased land prior to the date rental payment was due:

> Government well No. 3 was drilled on lease 08862. It encountered the upper and lower Dakota formations * * *. Both formations were tested by drill stem methods, and, in addition, a core analysis was made. Casing was set in the well * * * however, the casing was not perforated nor a production test made. (Emphasis added.)

The decision then noted that while the Department had not construed the language "any lease in which there is a well capable of producing oil and gas in paying quantities," it said the Department has indicated the view in other connections that it means a well which is in physical condition to produce. After examining Steelco Drilling Corporation, 64 I.D. 214 (1947) and H. K. Riddle, 62 I.D. 81 (1955), the decision stated:

> It is quite apparent that Department has construed the phrase "well capable of producing" to mean a well which is actually in condition to produce at the particular time in question. This accords with the literal meaning of the phrase and is therefore adopted as the proper meaning of the phrase as used in the automatic termination provision.

The Department restated its conclusion in Joseph C. Sterge, 70 I.D. 375 (1963), when the issue was whether there was an oil and gas lease a well capable of producing oil or gas in paying quantities so that the lease would not have terminated for failure to pay the annual rental. 30 U.S.C. § 188(b). It pointed out that although the drilling of the well in United had been completed, the casing set and cemented, the casing had not been perforated so that the well was not, therefore, in physical condition to product.

Again in Carl Losey, A-30153 (December 4, 1964), the appellant contended that an oil and gas lease had not terminated at the end of its term because it had on it a well capable of producing oil and gas in paying quantities. The record showed that a well had been drilled and shut in with a well head and valve, but no casing had been installed. Losey alleged he had produced about 14 gallons of oil per hour in bailer tests and 15 barrels per day in test production. However, there was no evidence in the record that the well could meet such tests. The Department restated its position that a well capable of producing means "a well which is actually in physical condition to produce at the particular time in question," citing United and Sterge. The well, it held, must be "capable of present production" and that a 60 day notice need be sent only when there is a completed well capable of production. It concluded that Losey's well had never been completed, the casing never installed and that potential production from the wells was most doubtful. It then held that the lease had terminated.

These cases establish that for a lease to be extended or to avoid automatic termination for failure to pay the rental on its anniversary date, by reason of its having "a well capable of

producing oil or gas in paying quantities" the well must actually have been in a physical condition to produce and not at some intermediate stage in the process.

Here at the very least, the casing had not been perforated. The casing had been extended through the prospective producing zone, but had not been perforated in that zone. Therefore, the well had never been actually in a condition to produce.

The appellant contends that our decision in Joseph I. O'Neill, Jr., 77 I.D. 181, 1 IBLA 56 (1970) has fully discounted the perforation criterion. To the contrary, O'Neill reaffirms the Department's definition of a well capable of production. In O'Neill the lessee sought a two year extension of one segregated part, A, of a lease on the basis of a discovery of oil and gas on another segregated portion, D, of the same original lease. 30 U.S.C. § 187(a) (1970). The issue was whether there has been a "discovery" on D. O'Neill alleged that a well had been drilled on D, that drill stem tests had been taken in 3 formations, which "definitely indicate a discovery of oil and gas in commercial quantities."

The Geological Survey reported that it did not disagree with the drill stem test data, but concluded that a "discovery" required a well that is physically capable of producing oil and gas in paying quantities.

The land office held the lease terminated on appeal to the Director, Bureau of Land Management, the land office decision was affirmed by the Chief, Branch of Mineral Appeals, who held that the statutory requirements for discovery of oil or gas in paying quantities is not met until there is on the lease a well capable of producing oil or gas in paying quantities after drilling has been completed, casing set and cemented, and perforations made into the appropriate horizon so that the well is physically capable of production, citing United Manufacturing Co. and Sterge, supra.

On appeal to the Department, O'Neill contended that "discovery does not require "production." He also contended that there had been a discovery of paying quantities of gas. In support he set out in detail the drill stem tests, drilling reports, various technical logs, and opinions of several oil and gas professionals.

The Board referred to section 31 of the Mineral Leasing Act as amended, 30 U.S.C. § 188(b), which as added in 1954, provided:

> * * * upon failure of a lessee to pay rental on or before the anniversary date of the lease, for

> any lease on which there is no well capable of producing oil or gas in paying quantities, the lease shall automatically terminate.

As we have seen this is the same phrase used in section 226 upon which appellant's right to an extension rests.

The Board then stated that section 31 imposes a specific statutory requirement for a well capable of producing oil or gas in paying quantities if the lease is to be spared automatic termination (or gain an extension). After pointing out that the "discovery" provision 30 U.S.C. § 187(a) reads "after the date of discovery of oil or gas in paying quantities," it said:

> The last-quoted statute, of course, is the one with which this appeal is concerned, since it affords the benefit sought by the appellants. However, all of the authorities relied upon by the Bureau of Land Management and the Geological Survey to establish that a completed well is required involve cases arising out of nonpayment of rentals and the consequent termination of the leases pursuant to 30 U.S.C. sec. 188(b). The conclusion is inescapable that BLM and the Survey have taken the requirement for a well capable of producing oil or gas in paying quantities, which was written into 30 U.S.C. sec. 187(a), as the essential test of a discovery of oil or gas in paying quantities.
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> We think such interpretation is improper. There is no basis for believing that in 1946, when the Congress provided that discovery of oil or gas in paying quantities would qualify another segregated portion of the same lease for extension, it intended to impose a requirement not even articulated in the Mining Leasing Act until eight years later in an amendment dealing with nonpayment of lease rental - an entirely different situation. Had it been the intent of Congress that there must be a completed well physically capable of economic production in order to qualify the extension it could easily have so provided. It did not. Only "discovery of oil and gas in paying quantities" is required.
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> This is not to say that in no event will it ever be necessary to complete a well in order to demonstrate a qualifying discovery. We recognize that situations may arise where adequate testing has not been accomplished or test results and other evidence are inconclusive and only the initial production test after completion of the well will demonstrate whether a discovery has

> been made. However, where all the evidence and expert opinion is reasonably persuasive of the fact of a discovery of paying quantities of oil or gas, as in this instance, it is error to hold that such evidence must be disregarded because the law and/or the regulations require a completed well, physically capable of oil or gas production in paying quantities.

The discussion makes plain that O'Neill assumes the validity of the United standard for determining whether there is "well capable of production" on a lease and that Congress in using that phrase in contrast to "discovery" expressly intended that to qualify under the former phrase "there must be a completed well physically capable of economic production."

To hold as appellant suggests would be to eradicate the distinction between the "discovery of oil and gas in paying quantities" and a "well capable of producing oil and gas in paying quantities."

The other case appellant cites is Texas National Petroleum Co., N.M. 021121 (BLM, April 17, 1962). This decision did not receive Secretarial review on its merits, and its basic holding that "discovery requires a well capable of production" is contrary to the holding of O'Neill. For our purposes it is relevant only insofar as it discussed the meaning of the latter phrase. The appellant argues that Texas National held that perforation was not determinative. To the contrary, Texas National held that despite drilling through the productive zones on November 30, 1960, running of electric logs on December 1, 1960, running or cementing of casing on December 2, 1960, plus professional opinion that the information available prior to midnight of November 30, 1960, proved conclusively that sands had been penetrated which would produce gas in paying quantities, the earliest date on which there was a well capable of production was December 8, 1960. At that time a completion unit had been moved in, the casing perforated, the formation sand fractured, and a production test run through a 3/4 inch choke.

Here appellant has neither perforated the casing, fractured the sand, nor run a production test after having performed those two operations. There is nothing in O'Neill or Texas National contrary to the teaching of United. In fact, they reaffirm it.

Accordingly, we conclude that the land office properly determined that there was on lease U 0146920 no well capable of producing oil or gas in paying quantities and that as a result it terminated at the expiration of its five-year term, August 31, 1970.

Therefore, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the letter decision of the Utah State Office is affirmed.

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Martin Ritvo
Administrative Judge

We concur:

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Douglas E. Henriques
Administrative Judge

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Anne Poindexter Lewis
Administrative Judge